P2P Lending Platform as a Financial Tool for SME in India

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Abstract

Peer-to-peer (P2P) lending is a business model that matches lenders and borrowers over an online platform to provide unsecured loans, repayable with interest. At a time when banks are tightening their purse strings, P2P lending platforms are witnessing steady traction as they serve the huge section of borrowers who fail to qualify for a loan by having no or poor credit scores. Initially, there were not many takers for P2P lending platforms due to lack of awareness and ambiguity over regulations. However, with the central bank asking such companies to register themselves as NBFC, things have started looking up. The results indicate that, at present, the level of awareness amongst SMEs on Peer-to-Peer lending as alternative financing instruments is still insufficient.

In terms of digital technology adoption among Small and Medium Enterprises (SMEs) and start-ups, there is a need of proper initiatives to increase the level of technology adoption amongst SMEs and start-ups to a higher level and to change the various aspects of business practices to encourage SMEs to move into the digital space. The results suggest that there is a need to raise awareness among Small Medium Enterprises and start-ups by authorized government related body.

Keywords: *P2P lending, Small and Medium Enterprises*

Paper Type: *Survey Research*

Introduction

Peer to Peer lending, also known as P2P Lending, is a method of debt financing that enables individuals to borrow and lend money without the use of an official financial as an intermediary through online services Peer to peer.

In India, P2P Lending is gaining traction at a very fast pace and slowly becoming a very attractive investment option for investors. RBI has already taken an initiative of this innovation and come up with notifications to regulate this sector.

Currently, at a nascent stage, the P2P lending landscape in India is poised to grow into a $4 Bn-$5 Bn industry by 2023. The domain's origin actually dates back to 2012, when the first peer-to-peer lending company i-Lend was launched. At present, the P2P lending space is populated by more than 30 players including Faircent, LendBox, LenDenClub, Rupaiya Exchange, LoanBaba, i2iFunding and many more.

Importance of P2P Companies

Prior to the financial crisis of the 2000s-2009s, the banks had a monopoly on lending money to businesses and individuals. This created a funding gap for new and growing businesses. Small to Medium sized enterprise business (SME) owners faced a lot of difficulties to borrow money from large financial institutions. The road show of rejection was common and if a bank did choose to lend money to an SME it was often at the very high-interest rate. This stifled the growth of the start-up landscape and of growing businesses trying to compete with established ones that had relatively easy access to finance. It also made it very difficult for individuals to borrow money from their bank even if loans were secured against fixed assets such as an individual's property.

In 2007-08 the financial crisis hit and bank lending to businesses and individuals alike rapidly dried up as banks began to consolidate their positions and tighten their lending due to revised capital reserve constraints. This created a debt funding gap and many businesses followed Zopa's lead and launched peer to peer (P2P) lending platforms. The P2P lending revolution started to gain momentum.

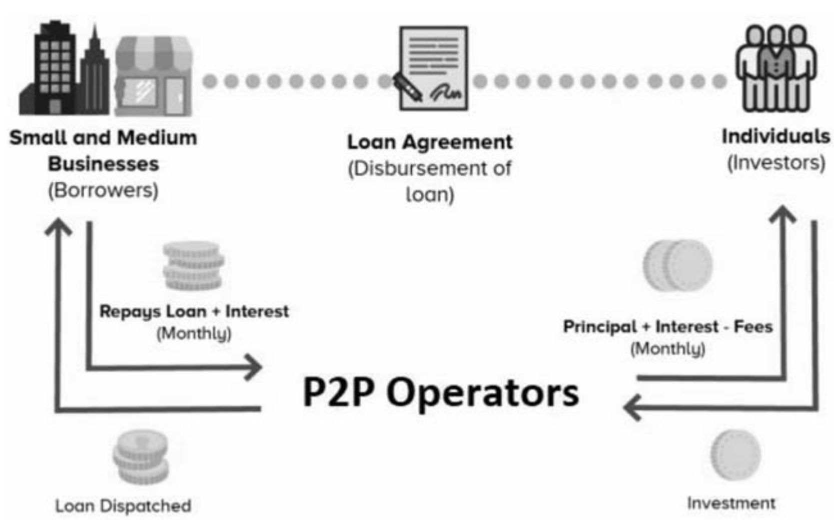
Peer-to-peer (P2P) lending in India is set to grow into a US$5 billion industry by 2023 as alternative finance continues to fill the void left by banks.

The Economic Survey 2017-18 tabled in the Parliament in January show that small and medium-sized enterprises (SMEs) continue to be seriously underserved by the traditional financial sector. The amount of credit or loans disbursed by banks amounted to Rs 26,041 billion (US$366 billion) as of November 2017 with only 17.4% going towards SMEs.

At a time when banks are tightening their purse strings, P2P lending platforms are witnessing steady traction as they serve the huge section of borrowers who fail to qualify for a loan by having no or poor credit scores.

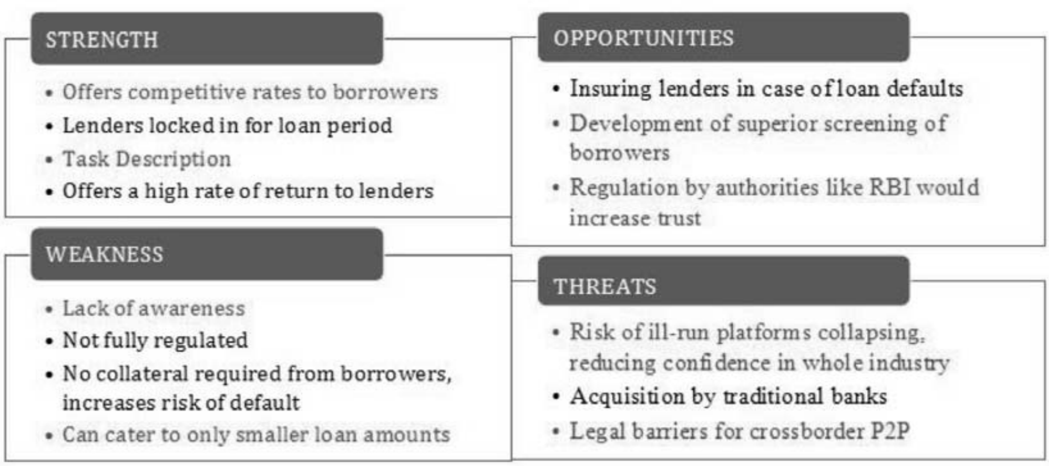
Borrowers, mostly SMEs, are taking these online platforms for hassle-free loans. For investors, also called lenders, it is the appeal of higher returns.

Functioning / Procedure of P2P



- Investor → Connects with borrowers through P2P platforms → Lends funds to borrowers → Earns a higher rate of interest depending on the risk involved
- Borrower → Can apply for a loan even if the CIBIL score has been adversely affected for some reasons → Pays interest proportional to his/ her credit score
- A peer to peer lending platform assess the loan risk associated with every borrower and assigns them a risk class. The borrowers are then allowed access to the portal where they can submit a loan request. The details are then made available to investors who can choose to fund part or full amount of the loan at an agreed rate of interest. The borrower pays EMI for the tenure of the loan which includes a principal and interest component.

SWOT Analysis of P2P Lending Platforms



Objective of the study

- To evaluate the awareness level of P2P lending among SMEs.
- To understand the perception of SMEs about P2P lending platforms.

Review of Literature

Galloway, (2009) studies that within P2P platforms borrowers generally describe the purpose of their loan request and provide information about their current financial situation, like income or open credit lines. Lenders then have the opportunity to offer a loan with an interest rate derived upon this information. For borrowers, online P2P lending is a way to receive a loan without a financial institution involved in the decision process and might also be a possibility to receive better conditions than in the traditional banking system.

Freedman and Jin, (2011) conclude, learning by doing plays an important role in alleviating the information asymmetry between market players. Although the P2P platform (Prosper.com) discloses part of borrowers' credit histories, lenders face serious information problems because the market is new and subject to adverse selection relative to offline markets. They found that early lenders did not fully understand the market risk but lender learning is effective in reducing the risk over time. As a result, the market excludes more and more sub-prime borrowers and evolves towards the population served by traditional credit markets.

According to Alloway Tracy, (2015) "Disintermediation," the idea that we can have credit without banks, became a political rallying cry for those interested in reforming the financial system to better serve the interests of consumers. As the Financial Times has put it, peer-to-peer lending companies offered to "revolutionize credit by cutting out, or disintermediating, banks from the traditional lending process."

Research Design

Data Collection

Secondary Data: Some sort of secondary data has been used in this research that was extracted from various sources viz: journals, books, e-books, reports, published and unpublished papers.

Primary Data: This study is based on the qualitative and quantitative research method

Primary research seeks to understand a given research problem or topic from the perspectives of the local population.

Population Size

The Study is related to all the SME borrowers across the Mumbai region.

Sample

Research Methodology includes a primary source of data which have been collected in the form of responses by interviewing 30 SME who are representative of businessmen especially SME. Direct personal interview was followed. Also, a structured questionnaire was used to collect data.

Data Analysis and Interpretations

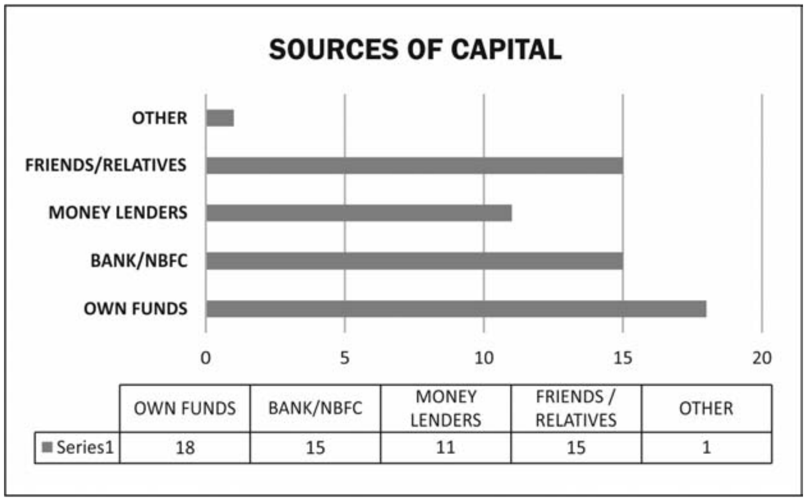
Responses from SMEs

- Reason for Capital Requirement

The reason for capital requirement for start-ups mainly for meeting to the preliminary expenses like professional consultation fees, real-estate, and other set-up expenses. Existing businesses require it for business expansion, repair, project investment, buying equipment, meeting credit requirement, product development and other working capital needs.

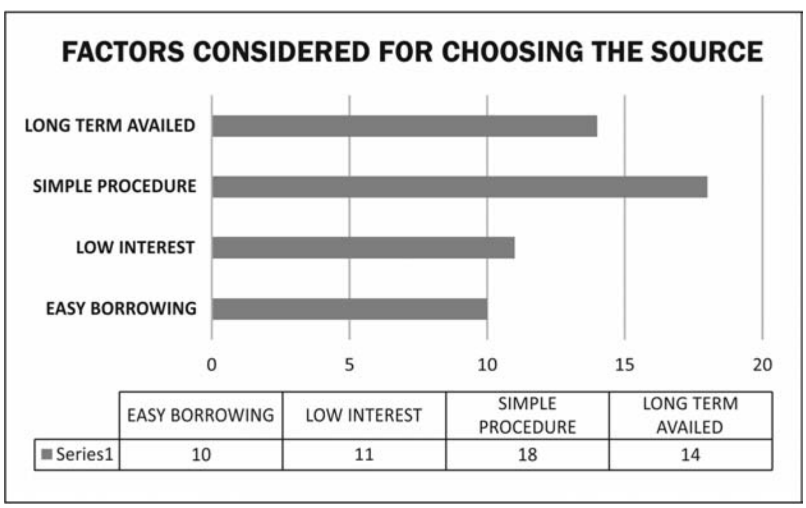
- Sources of Capital

Majority of the businessmen (90%) use their own fund if the nature of their business is small which does not require huge capital. 75% of respondents opt for a loan from the bank as they consider it to be the safest mode. Only 11% of the respondents borrow from money lenders because their rate of interest is high. Whereas 15% of respondents take help from friends/ relatives as they are a convenient source of capital. But only 1% of the respondents borrowed from NBFC which shows the lack of awareness of P2P lending in Mumbai.



- Factors considered for choosing the source

Above we found that the procedure of acquiring loan plays a major role in selecting the source, next to the term of the loan sets as a deciding factor followed by the interest rate on the loan amount and ease of borrowing. Hence, most small and medium enterprises reaching out to money lenders for procuring loans by following simple procedure enjoying longer duration of loans but their rate of interest was quite higher as compared to other sources.



- Interest Applied

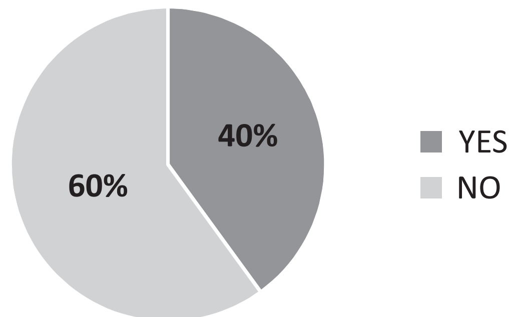
The rate of interest range from an average of 5% to 18%. The interest rate of a loan from bank or NBFC is fixed depending on the credit rating, banking stability, and existence if the business as well the proper maintenance of account and financial information. Whereas, borrowing from moneylenders have no uniform criteria for determining the interest rate.

- Processing Fees

The cost incurred to acquire capital i.e processing fees ranges from 1% -5%. This is not refundable and no interest will be provided on the same. No matter what loan you are looking for, this charge is unavoidable and is expected to be paid at the initial stages.

- Awareness of P2P lending platforms among borrowers

EVALUATING THE AWARENESS LEVEL OF P2P AMONG SMEs

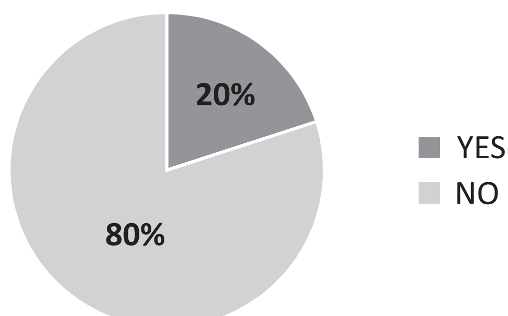


Source: Primary Data

It was observed that only 40% of the population are aware of the facility of the P2P Lending Platforms. P2P industry being in a nascent stage, also many SME are not tech savvy makes the awareness level low.

- If ever borrowed from P2P Lending platforms

BORROWED FROM P2P PLATFORMS

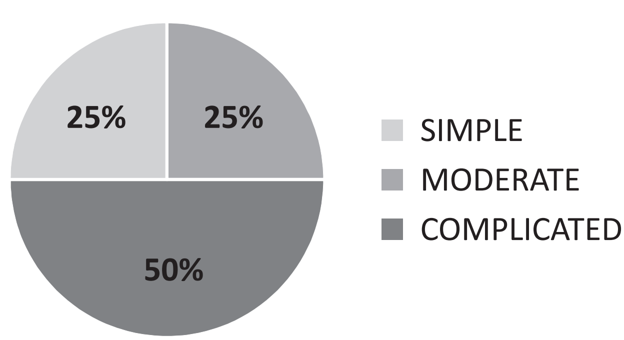


Source: Primary Data

Even if a small % of respondents are aware of such P2P lending platforms the % of respondents actually borrowed from such platform is even lower. Speculations around the industry and absence of specific laws and regulations governing the system in the nascent stage could be the major reasons for not investing in these sites.

- Responses from borrowers who have already borrowed from P2P lending Platforms

1. How was the Procedure?



Source: Primary Data

Only 25% of borrowers found the procedure of borrowing from P2P lending websites complicated as the amount of documentation seemed confusing to some P2P borrowers, and another 25% found it simple to acquire a loan from the websites. Whereas almost 50% felt the procedure of borrowing from such website was moderate since the P2P borrowers had some issue with communicating with the employees of the p2p lending platform.

2. Interest applied by P2P lending platforms

Among the borrowers who acquired a loan from the P2P lending Platforms they got an interest rate of 12.5%, 16% and 17.5%. They emphasized that the interest rate depends on various variables especially on the risk involved in the loan agreement.

3. Credit Score

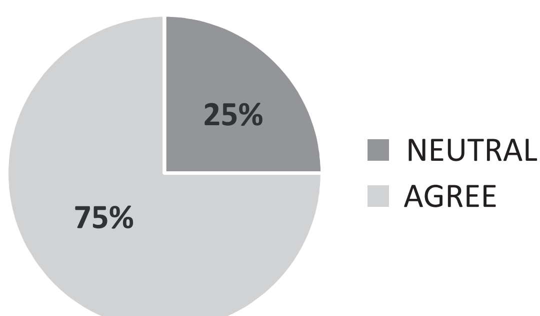
Among the borrowers who borrowed from such P2P lending Platforms, their credit score was between 500 to 600 or 600 to 700. This is one the factor which leads them to borrow from P2P platforms.

Credit Score	Between 500-600	Between 600-700	700 and above
Interest Rate	17.5%	16%	12.5%

4. Processing Fees

The % of processing fees incurred for acquiring the loan from P2P lending platforms ranges from 1% to 3% of the loan amount. It varies from different P2P lending platforms.

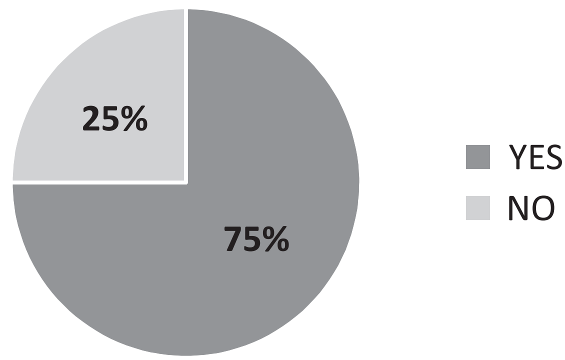
5. Will P2P lending be a credible challenger to high street banks?



Among the borrowers who acquired a loan from P2P lending Platforms 75% of the borrowers agree that such sites could be credible challengers to high street banks. And the 25% are neutral of the chances of the p2p lending platform being a challenger to traditional banks.

6. Do P2P lending platforms offer more value than Banks?

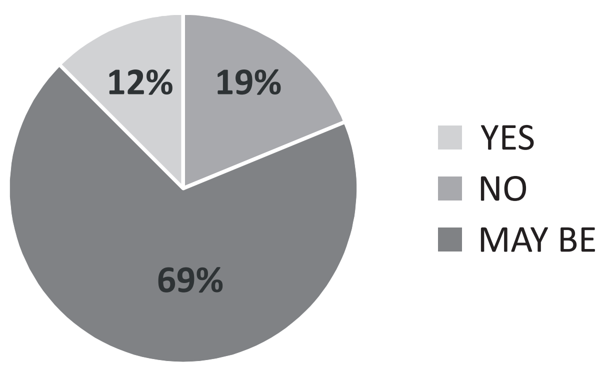
Majority of P2P borrowers believe that p2p lending platforms offer more value than banks. The reason for their presumption is the fact that there is a chance for borrowers low credit score or who don't have enough collateral which would have been rejected by the traditional banks.



Responses from SMEs who have not borrowed from P2P lending platforms

1. Would they try P2P lending in the future?

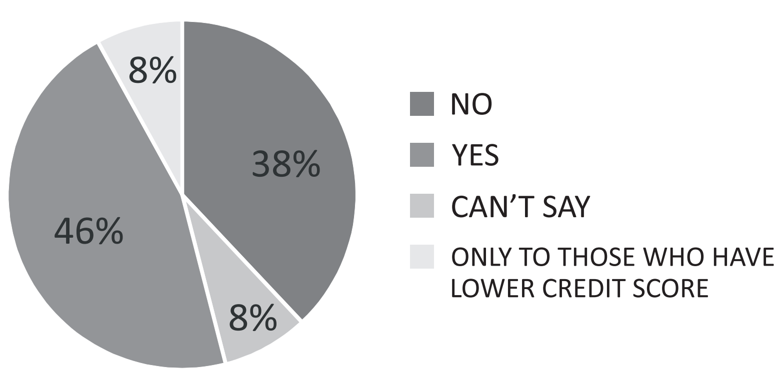
CONSIDERATION OF P2P LENDING AS A FINANCIAL TOOL



Source: Primary Data

68.7% of the businessmen in the population said they won't use P2P platforms for acquiring a loan as the nascent stage of the industry brings in lots of speculations around it, rest 12.5% showed some inclination towards such platforms and 18.8 % were sure to give it a try for the growth of their business as for easier loan financing with no collateral involved seems an appealing offer to the small and medium enterprises.

2. Will, they be offered better interest rates by P2P lending Platforms?

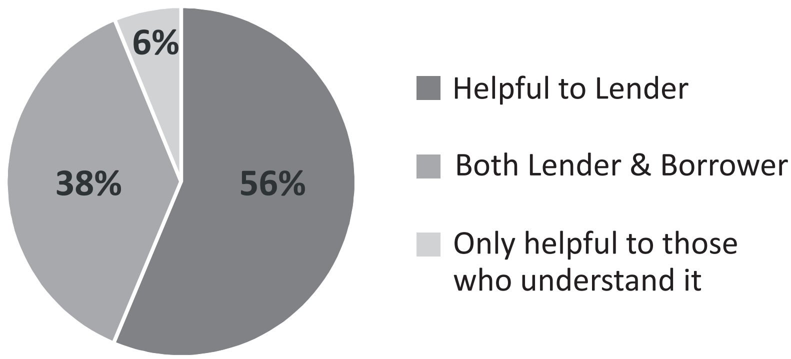


Since most of the borrowers are new to the concept of P2P lending platforms, hence, we found that 80% of the borrowers believe they won't get better offers than already available in the market. Around 13.3%

think they will get better interest rates, theorizing that with better interest rates the only catch would be the amount of EMI would be higher. 6.7% of the SME borrowers feel only those who have lower credit score may get better interest rates.

3. Would it be helpful to individuals (lenders or borrowers)?

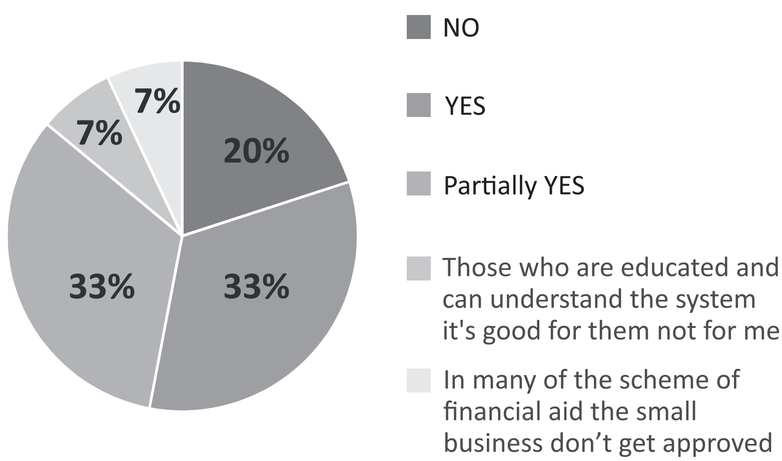
PERCEPTION ABOUT THE BENEFIT OF P2P LENDING PLATFORMS



Source: Primary Data

From the responses collected it is clear that more than half of the borrowers theorizing that the P2P lending platforms are helpful only to lenders as they get a higher rate of return leading to higher interest rates for the borrowers. About 37.5% think it is helpful for both lender and borrower, as the borrowers felt that it gives them the opportunity to be identified by lenders and they get easy loans without collateral. Others feel such platforms are helpful for only those who thoroughly understand the P2P lending platform.

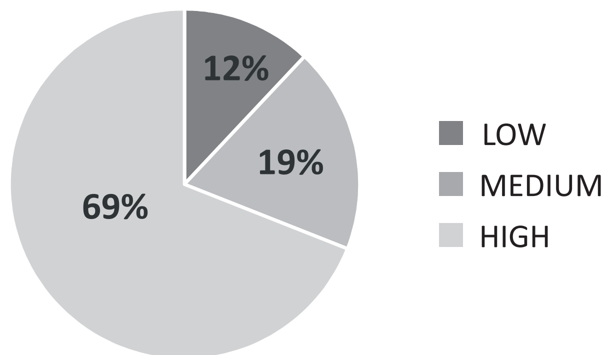
4. Will P2P lending help Make in India Programme?



As in the above pie chart, we observe most borrowers presume that the P2P lending platforms may boost in the Make in India Programme if the SME get approved.

Around 25% of the population still sceptical about the platforms and think it won't help in Make in India Programme. Others believe only those SME businessmen who are educated and can understand the P2P lending mechanism such platform can beneficial only to them. Also, they are convinced that financial ease of acquiring loan won't be approved for SME businessmen.

5. Risk Factor from borrowing in P2P lending



Since the awareness of P2P lending is low and the scepticism around it, 68.8% of the population believe there is high risk involved in borrowing from such P2P lending Platforms. It is because of the lack of awareness and ambiguity of the P2P lending industry. Whereas 12.5% think there is a low risk of borrowing from such sites as the risk only being not getting approved by the lending website and penalty interest to be paid in the case of late payment. Rest of 18.8% feel there is medium risk involved while borrowing from such websites. As they feel there is potential for the industry to expand and cater to the needs of the borrowers and lenders.

Contribution of the Study

Though this study is 'pilot study' in nature, it throws light on the lack of awareness of P2P lending industry, thereby small and medium businessmen and potential investors missing out on the chance of getting easy debt finance and the earning marginal return on investment.

In the light of this study, we believe that down the line a day is not far when the RBI will consider permitting the P2P players to operate offline as well in a move to fuel the financial growth in the country, incidentally also boosting the growth of P2P ecosystem, especially in rural and semi-urban areas.

Suggestions of the Study

Suggestions to Government/Regulatory bodies

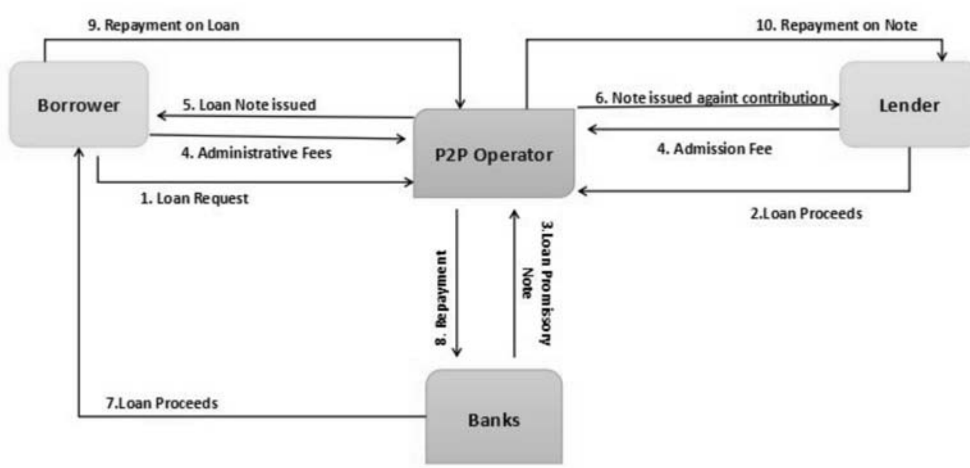
- Government and related authorities need to put more effort not only in increasing the awareness and knowledge of SMEs and start-ups about P2P lending platforms but also how the alternative can benefit them to move forward. Guidance through mass and social media should frequently be implemented by authorized bodies
- Efforts should be made to increase financial literacy among Indian SMEs and start-up especially in P2P Lending as this financial knowledge would affect to increase the firm's total sources of financing.
- The government should make it mandatory for the borrowers to take insurance of the loan amount as a precautionary measure against unforeseen situations like accidents, sickness, loss in business or death.

- Periodic review of the credit policy of P2P lending Platforms needs to be done to ensure that the policies and processes are in tune with business needs and scale.
- Relaxation in foreclosure interest for SMEs in order to motivate them to make prepayments.

Suggestions to P2P borrowers

Borrowers should disclose all the facts and information to the prospective investor as transparency will create confidence in the minds of the investor. They need to be cautious while preparing their profile online. Also, they should keep updating their profiles with new advancements in the business. The borrowers should state the projections of their business to the investors in order to convince the lenders to invest in their business idea.

Suggested Model for P2P Companies



In the suggested model, The P2P platform only acts as a mediator, uniting borrowers and lenders, and it is the bank that issues loans and sells them to investors. The borrower puts forward a loan request to the P2P platform. The P2P then forwards the loan request to a commercial bank associated with the P2P, the bank then sanctions the loan and issues a note promising to pay the debt to the P2P. They issue the note to the borrower against which the bank issue the loan amount to the borrower. Meanwhile, The lender then selects on the loans they want in their portfolio; once the amount of money required is reached, the loan is set for the process of issuing it. However, instead of originating the loan themselves, a bank steps in originates the loan. The platform then generates a note to the lender for the value of their contribution to the loan. The note is considered to be security similar to a promissory note. Hence, shifts the risk of loan non-payment to the lenders themselves and away from the bank originating the loan. In this model, the borrower shall bear the administration fee and an annual percentage indicated to them, which the combination of all costs and interest rate. The fees to the lenders shall only be restricted to the admission fees.

This form of P2P model is advantageous to the borrowers as they do not need to wait for a lender to identify him/her and advance them loans, instead the P2P helps the borrowers by facilitating the banks to originate the loans and later converting the loan into a P2P loan.

Conclusion of the Study

In terms of digital technology adoption among SMEs and start-ups, there is a need and proper initiatives to increase the level of technology adoption among SMEs and start-ups to a higher level and change the various aspects of business practices to encourage SMEs to move into the digital space. Other than that, it is obvious that a level of confidence put by most SMEs and start-ups on the financial services provided by non-banks is still very low.

The recently introduced regulations will play a hand in formally recognizing this industry. The Regulator has, perhaps, erred on the side of caution, much like the instinct of regulatory bodies around the world. The guidelines are certainly on the strict side. To be sure, there will be modifications and further clarifications added to these regulations; and they will play a large part in allowing for controlled and regulated expansion of the market.

As technology changes the ways in which we interact and transact, P2P lending is certainly a novel method which cuts the need for financial intermediation by banks and financial institutions. While our algorithms evolve to be able to accurately capture risks of default, the discretionary touch of human intervention will be important in markets as nascent as in India. While this is certainly a controlled growth phase in the market, all eyes will be on this market to see if it can evolve to become the next big disruption in the financial services industry.

Limitation of the Study

Despite all efforts and dedication towards this study, there are some limitations to this research which are as follows:

- Sample size: The sample size for this study is too small for a diversified country like India.
- Instruments for data collection: As interviews are face to face and verbal method of data collection, therefore, it is possible that with the mood the answers of the respondent may change. Businessmen were busy with their routine operations.

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Footnote

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